

ARRHYTHMIA RESEARCH TECHNOLOGY INC /DE/  
Form 10-Q  
May 17, 2012

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended March 31, 2012 or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

001-9731  
(Commission file No.)

ARRHYTHMIA RESEARCH TECHNOLOGY, INC.  
(Exact name of registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of incorporation or organization)

72-0925679  
(I.R.S. employer identification no.)

25 Sawyer Passway  
Fitchburg, Massachusetts 01420  
(Address of principal executive offices)

(978) 345-5000  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the previous 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  
X No\_\_\_.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of

this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer [  ]    Accelerated filer [  ]    Non-Accelerated filer [  ]    Smaller reporting company [  ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of May 7, 2012 there were 2,790,514 shares of the Company's common stock outstanding.

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ARRHYTHMIA RESEARCH TECHNOLOGY, INC.

TABLE OF CONTENTS

FORM 10-Q

March 31, 2012

<u>PART I - FINANCIAL INFORMATION</u>	<u>1</u>
<u>Item 1. Consolidated Financial Statements</u>	<u>1</u>
<u>Consolidated Balance Sheets</u>	<u>1</u>
<u>Consolidated Statements of Comprehensive Income (Loss)</u>	<u>2</u>
<u>Consolidated Statement of Changes in Shareholders' Equity</u>	<u>3</u>
<u>Consolidated Statements of Cash Flows</u>	<u>4</u>
<u>Notes to the Consolidated Financial Statements</u>	<u>5</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>9</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risks</u>	<u>14</u>
<u>Item 4. Controls and Procedures</u>	<u>14</u>
<u>PART II - OTHER INFORMATION</u>	<u>15</u>
<u>Item 6. Exhibits</u>	<u>16</u>
<u>SIGNATURES</u>	<u>16</u>
Exhibit 31.1 Certification of Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002	X-1
Exhibit 31.2 Certification of Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002	X-2
Exhibit 32.1 Certification of Chief Executive Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002	X-3
Exhibit 32.2 Certification of Chief Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002	X-4

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## PART I - FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements

## ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

ASSETS	March 31, 2012	December 31, 2011
Current assets:	(Unaudited)	(Audited)
Cash and cash equivalents	\$485,781	\$1,358,223
Trade accounts receivable, net of allowance for doubtful accounts of \$83,996 and \$58,496, respectively	4,325,994	3,501,744
Inventories, net	3,453,130	3,269,482
Deferred income taxes, net	64,100	23,700
Prepaid tax	193,595	188,640
Deposits, prepaid expenses and other current assets	1,109,653	668,482
Total current assets	9,632,253	9,010,271
Property and equipment, net of accumulated depreciation of \$10,385,220 and \$10,393,560, respectively	8,594,963	8,587,669
Goodwill	1,479,727	1,479,727
Other intangible assets, net	180,672	149,763
Total assets	\$19,887,615	\$19,227,430
 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$3,249,661	\$2,327,114
Accrued expenses	420,949	331,929
Customer deposits	—	232,550
Current portion of equipment note	105,384	—
Total current liabilities	3,775,994	2,891,593
Long term liabilities:		
Long term deferred tax liability, net	251,000	470,000
Long term portion of deferred gain on lease	12,284	13,401
Long term portion of equipment note	417,885	—
Total long term liabilities	681,169	483,401
Total liabilities	4,457,163	3,374,994
Shareholders' equity:		
Preferred stock, \$1 par value; 2,000,000 shares authorized, none issued	—	—
Common stock, \$0.01 par value; 10,000,000 shares authorized, 3,926,491 shares issued, 2,790,514 outstanding	39,265	39,265

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Additional paid-in-capital	10,799,858	10,762,338
Common stock held in treasury, 1,135,977 shares at cost	(3,099,842 )	(3,099,842 )
Accumulated other comprehensive income from foreign currency translation	42,502	42,502
Retained earnings	7,648,669	8,108,173
Total shareholders' equity	15,430,452	15,852,436
Total liabilities and shareholders' equity	\$19,887,615	\$19,227,430

The accompanying notes are an integral part of the consolidated financial statements.

## ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARIES

## Consolidated Statements of Comprehensive Income (Loss)

(Unaudited)

	Three months ended March 31,	
	2012	2011
Revenue	\$6,305,182	\$6,183,065
Cost of sales	5,194,757	4,804,779
Gross profit	1,110,425	1,378,286
Selling and marketing	629,965	360,013
General and administrative	975,380	878,370
Research and development	136,740	81,208
Income (loss) from operations	(631,660)	) 58,695
Other expense, net	(7,625)	) (10,562)
Income (loss) before income tax	(639,285)	) 48,133
Income tax provision (benefit)	(263,900)	) 21,000
Net income (loss)	\$(375,385)	) \$27,133
Net income (loss) per share – basic	\$(0.13)	) \$0.01
Net income (loss) per share – diluted	\$(0.13)	) \$0.01
Weighted average common shares		
Outstanding – basic	2,790,514	2,790,514
Weighted average common shares		
Outstanding – diluted	2,790,514	2,829,518
Other comprehensive income		
Foreign currency translation adjustments	—	25,519
Other comprehensive income	—	25,519
Comprehensive income (loss)	\$(375,385)	) \$52,652

The accompanying notes are an integral part of the consolidated financial statements.

## ARRHYTHMIA RESEARCH TECHNOLOGIES, INC. AND SUBSIDIARIES

## Consolidated Statement of Changes in Shareholders' Equity

(Unaudited)

	Common Stock		Additional paid-in capital	Treasury stock	Accumulated other comprehensive income	Retained earnings	Total
	Shares	Amount					
December 31, 2011	3,926,491	\$39,265	\$10,762,338	\$ (3,099,842)	\$ 42,502	\$8,108,173	\$15,852,436
Share-based compensation			37,520				37,520
Cash dividends						(84,119 )	(84,119 )
Net loss						(375,385 )	(375,385 )
March 31, 2012	3,926,491	\$39,265	\$10,799,858	\$ (3,099,842)	\$ 42,502	\$7,648,669	\$15,430,452

The accompanying notes are an integral part of the consolidated financial statements.

## ARRHYTHMIA RESEARCH TECHNOLOGY, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(Unaudited)

	Three months ended March 31,	
	2012	2011
Cash flows from operating activities:		
Net income (loss)	\$ (375,385	) \$ 27,133
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Amortization of the gain on lease	(1,117	) (1,117
Depreciation and amortization	468,312	382,309
Share based compensation	37,520	37,235
Provision for doubtful accounts	25,500	5,000
Deferred income tax	(259,400	) (96,500
Changes in operating assets and liabilities:		
Trade accounts receivable	(849,750	) (493,071
Inventories	(183,648	) (57,503
Deposits, prepaid expenses and other assets	(446,126	) 95,607
Accounts payable, accrued expenses and customer deposits	779,017	(868,447
Net cash used in operating activities	(805,077	) (969,354
Cash flows from investing activities:		
Capital expenditures	(810,400	) (402,647
Proceeds received from sale of fixed assets	303,885	—
Net cash used in investing activities	(506,515	) (402,647
Cash flows from financing activities:		
Proceeds from equipment note	523,269	—
Cash dividend paid	(84,119	) (168,236
Net cash provided by (used in) financing activities	439,150	(168,236
Effect of currency translation on cash and cash equivalents	—	25,219
Net decrease in cash and cash equivalents	(872,442	) (1,515,018
Cash and cash equivalents at beginning of period	1,358,223	3,962,454
Cash and cash equivalents at end of period	\$ 485,781	\$ 2,447,436

The accompanying notes are an integral part of the consolidated financial statements.



## Notes to the Consolidated Financial Statements

## 1. Basis of Presentation:

The unaudited interim consolidated financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, certain information and footnote disclosures normally included in complete financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted pursuant to such rules and regulations. The accompanying unaudited interim consolidated financial statements and related notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Arrhythmia Research Technology, Inc. ("ART") and subsidiaries (the "Company") Annual Report on Form 10-K for the year ended December 31, 2011 filed with the SEC on April 25, 2012.

The information presented reflects, in the opinion of the management of the Company, all adjustments necessary for a fair presentation of the financial results for the interim period presented.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Operating results for interim periods are not necessarily indicative of results that may be expected for the entire fiscal year.

## Principles of Consolidation

The consolidated financial statements include the accounts of ART, WirelessDx and Micron (collectively the "Company"). All intercompany balances and transactions have been eliminated in consolidation.

## Accounts Receivable

Management regularly reviews accounts receivable to determine if any receivables will potentially be uncollectible. The Company includes any accounts receivable balances that are determined to be uncollectible, along with a general reserve, in our overall allowance for doubtful accounts. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. Based on the information available to us, management believes the allowance for doubtful accounts as of March 31, 2012 is adequate.

## 2. Inventories:

Inventories consist of the following as of:	March 31, 2012	December 31, 2011
Raw materials	\$ 755,438	\$ 647,906
Work-in-process	235,824	395,176
Finished goods	2,461,868	2,226,400
Total	\$ 3,453,130	\$ 3,269,482

The value of silver in inventory at March 31, 2012 and December 31, 2011 as a part of finished goods as plated sensors, work in process, or raw materials was \$843,507 and \$886,002, respectively.

## 3. Debt:

At March 31, 2012, the Company has an unsecured demand line of credit for \$3,000,000 that provides for borrowings up to 80% of eligible accounts receivable plus 50% of finished goods inventories up to a \$700,000 maximum at an interest rate of 2% over LIBOR. The interest rate at March 31, 2011 was 2.33%. This facility has no borrowing base charge. On March 16, 2011, ART obtained a \$1,000,000 letter of credit against the line of credit in favor of the Bank

of Nova Scotia, replacing the Province of Prince Edward Island's performance guarantee obtained in conjunction with the acquisition of WirelessDx in 2010. Subsequent to quarter end, an aggregate of \$500,000 was drawn on this line. The demand line of credit was renewed April 2012 and expires April 2013.

The agreement contains covenants that apply upon drawing on the line. The covenants relate to various matters including notice prior to executing further borrowings and security interests, merger or consolidation, acquisitions, guarantees, sales of assets other than in the normal course of business, leasing, changes in ownership and payment of dividends.

The Company has a master lease agreement with its bank that allows for money to be drawn on standard terms for the purchase of equipment. Said monies will be paid back over the life of the equipment. During the three months ended March 31, 2012, \$523,000 was drawn down to acquire production equipment for Micron and will be repaid over 5 years.

#### 4. Income Taxes:

The Company accounts for income taxes in accordance with ASC 740 "Income Taxes," which requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using tax rates in effect for the year in which the differences are expected to reverse.

As of December 31, 2011, the Company had recorded a valuation allowance against the Canadian portion of its deferred tax assets, consisting of a net operating loss carryforward. Based on the Company's pre-tax losses for the years since the acquisition, management determined that realization of the assets cannot be considered more likely than not at this time. As of March 31, 2012, management assessed the valuation allowance and determined a full valuation allowance was still necessary. If and when management determines the valuation allowance should be released, the adjustment would result in a tax benefit in the consolidated statements of comprehensive income (loss). As of March 31, 2012, the Company has federal and state net operating loss carryforwards totaling \$573,000 and \$244,000, respectively, that begin to expire in 2031. As of March 31, 2012, the Company has a foreign net operating loss carryforward totaling \$1,096,000 that begins to expire 2030.

The Company has decided to amend the returns for 2008 and 2010, in order to use some of its 2011 net operating losses. As a result of these amendments, federal research and development credits and corporate alternative minimum tax credits of \$90,000 and \$22,000, respectively, are now available in future periods. As a result of the 2011 activities, management expects to realize a federal research and development credit of \$85,000. The Company has unused state investment tax credits and research and development credits available for carryforward totaling \$86,000. The federal tax credits begin to expire in 2029 and state credits begin to expire in 2027.

The Company files income tax returns in the U.S. Federal jurisdiction and various state and foreign jurisdictions. The periods from 2008 to 2011 remain open to examination by the IRS, state, and foreign jurisdictions. The Company believes it is not subject to any significant tax risks related to uncertain tax positions. The Company does not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the three months ended March 31, 2012 and 2011.

#### 5. Share-Based Compensation:

The Company accounts for non-cash share-based compensation under ASC 718 "Stock Compensation," which establishes accounting for equity instruments exchanged for employee services. Under ASC 718, share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant).

For the three months ended March 31, 2012 and 2011, share-based compensation included in general and administrative expenses amounted to \$37,520 and \$37,235, respectively.

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model. Key assumptions used to estimate the fair value of the stock options include the exercise price of the award, the expected option term, and the expected volatility of the Company's stock over the option's expected term, the risk free interest rate over the option's expected term, and the Company's expected annual dividend yield. The Company believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of the Company's stock options for the three months ended March 31, 2012 and 2011. Estimates of fair values are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

There were no option grants for the three months ended March 31, 2012 and 2011.

#### Share-Based Incentive Plan

On March 10, 2010, the Company's Board of Directors adopted the Arrhythmia Research Technology, Inc. 2010 Equity Incentive Plan (the "2010 Plan") upon the recommendation of the Compensation Committee. The 2010 Plan was approved by stockholders at the 2010 Annual Meeting. The 2010 Plan authorizes the issuance of an aggregate of 500,000 shares, namely, 400,000 shares of our common stock plus an aggregate of 100,000 shares previously reserved

for issuance under the Company's 2005 Stock Award Plan (the "2005 Plan"). The 2010 Plan replaced in its entirety the 2005 Plan, under which no grants have been made. The Company's 2001 Stock Option Plan (the "2001 Plan"), which expired in 2011, will continue to govern outstanding options but no further options will be granted under the 2001 Plan. The Company has one plan providing the Company flexibility to award a mix of stock options, equity incentive grants, performance awards and other types of stock-based compensation and under which an aggregate of 500,000 shares have been reserved for such grants.

At March 31, 2012, the Company had one stock option plan that includes both incentive and non-qualified stock options to be granted to certain eligible employees, non-employee directors, or consultants. The maximum number of shares reserved for issuance is 500,000 shares. The options granted have either six or ten year contractual terms and either vest immediately or vest annually over a five-year term.

At March 31, 2012, there were 340,000 shares available for future grants under the above stock option plan.

The following table sets forth the stock option transactions for the quarter ended March 31, 2012:

	Number of shares	Weighted average exercise price	Weighted average remaining contractual term	Aggregate intrinsic value
Outstanding at December 31, 2011	409,000	\$ 6.78	5.20 years	\$—
Granted	—	—	—	—
Exercised	—	—	—	—
Forfeited/expired	—	—	—	—
Outstanding at March 31, 2012	409,000	\$ 6.78	5.18 years	\$ 14,345
Exercisable at March 31, 2012	145,000	\$ 7.50	2.22 years	\$ 5,738

During the three months ended March 31, 2012 and 2011, no options were exercised. At March 31, 2012 and 2011, the intrinsic value of the exercisable options is \$5,738 and \$42,659, respectively.

The following table sets forth the status of the Company's non-vested options for the three months ended March 31, 2012:

	Number of shares	Weighted average fair value
Non-vested at December 31, 2011	299,800	\$ 1.38
Granted	—	—
Vested	(35,800 )	1.95
Forfeited	—	—
Non-vested at March 31, 2012	264,000	\$ 1.30

The following table presents the average price and contractual life information about options outstanding and exercisable at March 31, 2012:

Exercise Price	Number of Outstanding Shares	Weighted Average Remaining Contractual Life (years)	Options Currently Exercisable	Average Fair Value at Grant Date
\$ 3.41	75,500	3.76	30,200	\$ 0.96
4.76	60,000	3.21	20,000	1.77
5.73	90,000	9.17	—	1.42
7.15	93,500	1.76	74,800	2.74
9.86	70,000	9.13	—	0.65
12.42	10,000	0.34	10,000	5.38
23.10	10,000	0.93	10,000	10.77
	409,000		145,000	

As of March 31, 2012, there was \$218,464 of unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the stock option plan. This cost is expected to be recognized over a weighted average period of 3.70 years.

#### 6. Earnings (loss) per share:

The Company follows the provisions of ASC 260 "Earnings Per Share," which requires the Company to present its basic earnings per share and diluted earnings per share, and certain other earnings per share disclosures for each year presented. Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding. The computation of diluted earnings per share is similar to

the computation of basic earnings per share except that the denominator is increased to include the average number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. In addition, the numerator is adjusted for any changes in income that would result from the assumed conversions of those potential shares. At March 31, 2012 and 2011, 333,500 stock options were antidilutive and were not included in the calculation of earnings or loss per share.

7

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7. Medical Services Revenue:

The Company's WirelessDx subsidiaries account for patient service revenues as net service revenues under Accounting Standards Update (ASU) 2011-07. This requires gross billed revenue to be reduced by an estimated allowance for contractual adjustments and uncollectibles to properly account for the anticipated difference between gross billed charge amounts and the expected reimbursement amounts.

The Company's contractual adjustments and uncollectibles as a percentage of gross patient service revenue will vary each year depending on several factors, including improved contracting with payers, changes in reimbursement from government sponsored programs, shifts in the percentage of patient services being reimbursed under insurance and the patients required co-insurance. Geography and demographics of the patient population will affect these estimates as the Company's historic expectations could differ from experience.

Gross service revenue in the three months ended March 31, 2012 was \$135,265. The revenue was adjusted by \$32,820 to account for expected contractual adjustments and uncollectibles, and an adjustment of \$13,403 to increase the previously recorded allowance. The net service revenue for the three months ended March 31, 2012 was \$89,042 as compared to \$13,577 in the same period of 2011.

8. Recent Pronouncements:

Accounting Standards Update (ASU) 2011-07, "Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts and the Allowance for Doubtful Accounts for Certain Health Care Entities" ("Update 2011-07"). Update 2011-07 requires certain health care entities to change the presentation in their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, those health care entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. The amendments also require disclosures of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. Update 2011-07 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2011. The adoption of this update did not have a material impact on the consolidated financial statements.

Accounting Standards Update (ASU) 2011-08, "Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment" ("Update 2011-08"). Update 2011-08 amends existing guidance by giving an entity the option to first assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50%) that the fair value of a reporting unit is less than its carrying amount, before performing the more detailed qualitative two-step goodwill impairment test which is used to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, which for the Company is the first quarter of 2012. Management does not believe the adoption of this update will have a material impact on the consolidated financial statements.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Forward-Looking Statements

Any forward looking statements made herein are based on current expectations of the Company that involve a number of risks and uncertainties and should not be considered as guarantees of future performance. These statements are made under the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. Forward looking statements may be identified by the use of words such as “expect,” “anticipate,” “believe,” “intend,” “plans,” “predict,” or “will”. Although the Company believes that our expectations are based on reasonable assumptions, we can give no assurance that our expectations will materialize. Many factors could cause actual results to differ materially from our forward looking statements. Several of these factors include, without limitation: our ability to maintain our current pricing model and/or decrease our cost of sales; our ability to increase sales of higher margin products and services; variations in the mix of products and services sold; variability of customer delivery requirements; ability to license our software, provide timely customization and updates; ability to successfully market WirelessDx services, manage the timing of investment in operational infrastructure and ability to accelerate the pace of revenues from customer implementation; a stable interest rate market and/or a stable currency rate environment in the world, and specifically the countries where we are doing business; continued availability of supplies or materials used in manufacturing at competitive prices; volatility in commodity and energy prices; the Company's ability to offset higher costs with price increases; adverse regulatory developments in the U.S. or any other country the Company plans to do business in; entrance of competitive products and services in the Company's markets; the ability of management to execute plans and motivate personnel in the execution of those plans; no adverse publicity related to the Company and/or its products; adverse claims relating to the Company's intellectual property; adoption of new, or changes in, accounting principles; passage of new, or changes in, regulations; legal proceedings; ability to maintain compliance with the NYSE Amex requirements for continued listing of our common stock; the costs inherent with complying with statutes and regulations applicable to public reporting companies, such as the Sarbanes-Oxley Act of 2002; the Company's ability to efficiently integrate acquisitions and other new lines of business that the Company may enter in the future, if any; and other risks referenced from time to time elsewhere in this report and in our filings with the SEC.

The Company is under no obligation and does not intend to update, revise or otherwise publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of any unanticipated events. More information about factors that potentially could affect the Company's financial results is included in the Company's filings with the SEC, including its Annual Report on Form 10-K for the year ended December 31, 2011.

### Overview

Arrhythmia Research Technology, Inc. (“ART”) is engaged in the licensing of medical software, which acquires data and analyzes electrical impulses of the heart to aid in the detection of potentially lethal arrhythmias. Micron Products, Inc. (“Micron”), a wholly-owned subsidiary, is the primary source of consolidated revenues. This primary source of revenue relates to the manufacturing of components, devices and equipment primarily for the medical and defense industries. The single largest category of revenue relates to Micron’s production and sale of silver/silver chloride coated and conductive resin sensors used as component parts in the manufacture of integrated disposable electrophysiological sensors. These disposable medical devices are used worldwide in the monitoring of electrical signals in various medical applications. In an effort to leverage these skills, the Company has expanded into custom thermoplastic injection molded products with a full array of design, engineering and production services and management. With the addition of a medical machining cell, the Company began production of patient specific metal and plastic orthopedic devices. RMDDxUSA Corp. together with its subsidiary RMDDx Corporation (such subsidiaries collectively, “WirelessDx”), a wholly-owned subsidiary of ART, provides medical software and services,



respectively, to the medical industry. While not currently adding significant revenue to the results, management believes these businesses have potential for future growth of the Company. Management continues to identify complementary and/or synergistic products, technologies and lines of business in an effort to broaden the Company's offerings.

9

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## Results of Operations

## Revenue

The Company's consolidated net sales for the three months ended March 31, 2012 were \$6,305,182, an increase of \$122,117 or 1.98%, when compared to the total net sales of \$6,183,065 in the three months ended March 31, 2011 as discussed by segment below.

Micron sales for the three months ended March 31, 2012 were \$6,216,140, an increase of \$46,652 or 0.8%, when compared to sales of \$6,169,488 in the same period in 2011. Micron continues to experience price pressure in a competitive global market. The revenue associated with the sensor business, including silver surcharge, increased as a result of increased volume. This increase in sensor revenue was offset by the expected decrease in MIT division's custom manufacturing in defense industry revenue.

WirelessDx net sales were \$89,042 for the three months ended March 31, 2012 compared to the net sales of \$13,577 in the same period in 2011. The medical monitoring segment continued its expansion efforts after receiving a contract with the Veterans Administration and being issued a provider number as an IDTF during 2011.

ART's net sales were \$0 for the three months ended March 31, 2012 and 2011. A new update to the ART's proprietary SAECG software, PREDICTOR®, expected to generate sales opportunities with ART's OEM customer in the Japanese market, was completed late in March 2012. This update to PREDICTOR is expected to yield revenues from license sales later in the year.

Revenue from domestic and foreign sales for the three month period is as follows:

	Three months ended March 31,			
	2012	%	2011	%
United States	\$2,596,966	41	\$2,666,295	43
Canada	1,800,209	29	1,903,889	31
Europe	699,474	11	643,260	11
Pacific Rim	587,125	9	509,972	8
Other	621,408	10	459,649	7
Total	\$6,305,182	100%	\$6,183,065	100%

## Cost of Sales

The Company's consolidated cost of sales was \$5,194,757 (82.4% of net sales) in the three months ended March 31, 2012 compared to \$4,804,779 (77.7% of net sales) in the three months ended March 31, 2011 an increase of \$389,978 or 8.1% as discussed by segment below. The increase in the consolidated cost of sales is mainly due to the WirelessDx segment.

Micron cost of sales was \$4,806,105 (77.3% of segment sales) in the three months ended March 31, 2012 compared to \$4,732,079 (76.7% of segment sales) in the same period in 2011 an increase of \$74,026 or 0.6%. The cost of silver has generally been passed on to our customers in the form of a surcharge. The surcharge protects Micron from decreasing gross profits from an increase in the cost of silver. Management routinely reviews its products and programs, including those in development, for contribution and value to our overall business strategy and results. Those that do not have contribution margins equal to or greater than the current average are the focus for process improvement teams. Programs with unacceptable margins will be phased out or discontinued, so that Micron's resources will be used to develop those of more strategic value.

WirelessDx cost of sales was \$388,652 in the three months ended March 31, 2012 compared to \$70,880 in the same period in 2011 an increase of \$317,772. The large increase includes the initial startup cost of monitoring and patient call centers. This cost is expected to grow at a slower pace as facilities are fully staffed and functional.

ART cost of sales was \$0 in the three months ended March 31, 2012 and \$1,820 in the same period in 2011. This cost related to sales in the prior period.

## Selling and Marketing

The Company's consolidated selling and marketing expense increased to \$629,965 (10.0% of net sales) in the three months ended March 31, 2012 from \$360,013 (5.8% of net sales) in the same period in 2011, an increase of \$269,952, or 75% as discussed by segment below.

Micron's selling and marketing expense decreased to \$189,133 (3.0% of segment sales) in the three months ended March 31, 2012 from \$208,709 (3.4% of segment sales) in the same period in 2011, a decrease of \$19,576. Micron's selling expense remained stable but is expected to increase in 2012 due to higher sales commissions as new programs begin. The increase in selling expense is not expected to increase as a percentage of sales.

WirelessDx's selling and marketing expense increased to \$391,375 in the three months ended March 31, 2012 from \$106,523 in the same period in 2011, an increase of \$284,852, or 267%. In 2012, the sales force was expanded during the first three months of 2012. Also contributing to the increase in expense was the cost of travel as the segment's growth included additional geographic markets. Business development expenses are expected to increase at a faster rate than revenue until scale is reached in late 2012.

ART's selling and marketing expense increased to \$49,457 in the three months ended March 31, 2012 from \$44,781 in the same period in 2011, an increase of \$4,676, or 10.4%. In 2012, expenses incurred were related to business development efforts, including travel and trade show expenses.

#### General and Administrative Expenses

The Company's consolidated general and administrative expense was \$975,380 (15.5% of net sales) in the three months ended March 31, 2012 as compared to \$878,370 (14.2% of net sales) in the same period in 2011, an increase of \$97,010 or 11.0% as discussed by segment below.

Micron's general and administrative expense decreased to \$214,460 (3.4% of net sales) in the three months ended March 31, 2012 from \$217,966 (3.5% of net sales) in the same period in 2011, a decrease of \$3,506.

WirelessDx's general and administrative expense increased to \$282,721 (4.5% of net sales) in the three months ended March 31, 2012 from \$233,305 (3.8% of net sales) in the same period in 2011, an increase of \$49,416. The expense for the segment includes executive salaries, back office support, and travel expenses.

ART's general and administrative expense was \$80,011 (1.3% of net sales) in the three months ended March 31, 2012 as compared to \$75,242 (1.2% of net sales) in the same period in 2011, a increase of \$4,769. This includes costs of the legal work on existing patents, travel expense associated with ART products and other costs to maintain the software library.

The Corporate segment increased to \$398,188 (6.3% of net sales) in the three months ended March 31, 2012 from \$351,857 (5.7% of net sales) in the same period in 2011, an increase of \$46,331. A large portion of this increase was the centralization of the finance and human resources departments to the Corporate segment. In 2011, personnel were transferred to this segment to provide support across all segments of the business. Other corporate and travel expenses include expansion of the Board of Directors compared to the comparable period as well as attendance at trade events.

#### Research and Development

The Company's consolidated research and development costs increased to \$136,740 (2.2% of net sales) in the three months ended March 31, 2012 from \$81,208 (1.3% of net sales) in the same period in 2011, an increase of \$55,532, or 68.4% as discussed by segment below.

Micron's research and development costs decreased to \$36,888 (0.6% of net sales) in the three months ended March 31, 2012 from \$49,852 (0.8% of net sales) in the same period in 2011, a decrease of \$12,964, or 26.0%. The expense is related to process improvements on the Micron sensors and snap product lines as well as new processes and capabilities within MIT.

WirelessDx's research and development costs increased to \$3,331 (0.1% of net sales) in the three months ended March 31, 2012 from \$0 in the same period in 2011, and increase of \$3,331. This expense is related to the documentation required for FDA clearance of devices.

ART's research and development expenses increased to \$96,521 (1.5% of net sales) in the three months ended March 31, 2012 from \$31,356 (0.5% of net sales) in the same period in 2011. Research and development expense in 2012 included the addition of a full-time employee, development work related to device accessories to be manufactured by Micron and used by WirelessDx, and additional technical consulting for PREDICTOR. The 2011 expenses included the technical support of a NIH research project utilizing ART's proprietary Signal Averaged ECG software and evaluation of other devices for software development.

#### Other Expense, Net

Other expense was \$7,625 in the three months ended March 31, 2012 compared to expense of \$10,562 in the same period in 2011. Other expense consists of miscellaneous expense items and currency losses relating to foreign operations in Canada.

#### Income Taxes

The Company's combined federal and state effective income tax rate was (41%) and 44% in the three months ended March 31, 2012 and the same period in 2011, respectively. The effective rates differed from the statutory rates primarily due to state and federal investment tax credits.

## Liquidity and Capital Resources

Working capital was \$5,856,259 at March 31, 2012 compared to \$6,118,678 at December 31, 2011, a decrease of \$262,419. Capital investment may decrease working capital with any significant investment resulting from future acquisition of capital assets or businesses, significant expansion of production capacity, or further software and product development.

Cash and cash equivalents were \$485,781 and \$1,358,223 at March 31, 2012, and December 31, 2011, respectively. Substantially all of these funds are invested in bank deposit accounts.

Net capital expenditures were \$810,400 for the first three months of 2012 as compared to \$402,647 for the same period in 2011. The largest portion of the capital expenditures in 2012 resulted from the routine replacement of production equipment and tooling on the Micron sensor product line. Other capital expenditures included monitoring software, internal portal modifications and monitoring devices for WirelessDx. Capital expenditures for the three months ended March 31, 2012 were made with cash on hand and the Company's equipment lease line. The Company has a master lease agreement with its bank that allows for money to be drawn on standard terms for the purchase of equipment. Said monies will be paid back over the life of the equipment. During the three months ended March 31, 2012, \$523,000 was drawn down to acquire production equipment for Micron and will be repaid over 5 years.

The Company has an unsecured demand line of credit with a large multinational bank with a credit limit of \$3 million. The agreement provides for borrowings up to 80% of eligible accounts receivable plus 50% of finished goods inventories. This facility has no borrowing base charge. The agreement contains covenants that apply upon drawing on the line. The covenants relate to various matters including notice prior to executing further borrowings and security interests, merger or consolidation, acquisitions, guarantees, sales of assets other than in the normal course of business, leasing, changes in ownership and payment of dividends. No funds have been drawn down on this line during the quarter ended March 31, 2012, but subsequent to the end of the period \$500,000 was drawn. Under this credit line, the Company has for the benefit of its subsidiary RMDDx secured a \$1,000,000 letter of credit to replace the guarantee by the Province of Prince Edward Island.

During the three months ended March 31, 2012, the Board of Directors declared and paid a quarterly cash dividend of \$0.03 per share for a total of \$84,119. In the comparable period ended March 31, 2011, the Board of Directors declared and paid a semi-annual cash dividend of \$0.06 per share for a total of \$168,236.

The Company has funded working capital and capital expenditures from operations and, subsequent to quarter end, from borrowings under the line of credit. Management believes that in the event the Company needs to fund working capital, and or future capital expenditures, financing alternatives are available.

## Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles requires management to make judgments, assumptions and estimates that affect the amounts reported. Certain of these significant accounting policies are considered to be critical accounting policies, as defined below.

A critical accounting policy is defined as one that is both material to the presentation of the Company's financial statements and requires management to make difficult, subjective, and complex judgments that could have a material effect on the Company's financial condition and results of operations. Specifically, critical accounting estimates have the following attributes: 1) the Company is required to make assumptions about matters that are highly uncertain at the time of the estimate; and 2) different estimates the Company could reasonably have used, or changes in the estimate that are reasonably likely to occur, would have a material effect on the Company's financial condition or results of operations.

Management believes that the following are critical accounting policies:

### Revenue Recognition

The Company recognizes revenue upon product shipment or completion of patient monitoring services, provided that there exists persuasive evidence of an arrangement, the fee is fixed or determinable, and collectability of the related

receivable is reasonably assured. Revenue from contracted commercial payers is recorded at the negotiated contractual rate.

WirelessDx recognizes service revenues derived from event and mobile cardiac telemetry services, a significant portion of which is from third party commercial payers and governmental entities. It also receives reimbursement directly from patients through co-insurance, deductibles and self-pay arrangements. Gross revenue is adjusted for contractual adjustments and bad debt to an estimated net realizable value, based on historical information. Revenue is earned when service is completed.

#### Accounts Receivable

Based on management's on-going analysis of accounts receivable balances, as to any event that adversely affects the ultimate ability to collect the related receivable, management will record an allowance for bad debts. Bad debts have not had a significant impact on the Company's financial position, results of operations and cash flows.

### Stock-Based Compensation

The Company accounts for share based compensation under ASC 718, "Stock Compensation" ("ASC 718"). ASC 718 requires that companies recognize and measure compensation expense for all share-based payments at the grant date based on the fair market value of the award. This share-based compensation expense must be included in the Company's results of operations over the requisite service period.

The Company uses the Black-Scholes option pricing model which requires extensive use of financial estimates and accounting judgment, including the expected volatility of the Company's common stock over the estimated term, and estimates on the expected time period that employees will retain their vested options prior to exercising them. The use of alternative assumptions could produce significantly different estimates of the fair value of the stock-based compensation and as a result, provide significantly different amounts recognized in the Company's statements of comprehensive income (loss).

### Inventory

The Company values its inventory at the lower of average cost or net realizable value (FIFO). The Company reviews its inventory for quantities in excess of production requirements, obsolescence and for compliance with internal quality specifications. Any adjustments to inventory would be equal to the difference between the cost of inventory and the estimated net market value based upon assumptions about future demand, market conditions and expected cost to distribute those products to market.

The Company provides for excess, slow moving, and obsolete inventory. A review of inventory on hand is made at least annually and obsolete inventory may be scrapped and/or recycled. The review is based on several factors including a current assessment of future product demand, historical experience, and product expiration.

### Deferred Tax Assets

The Company assesses its deferred tax assets based upon a more likely than not to be realized criteria. The Company considers future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance. The Company recognizes the benefits of a tax position if that position is more likely than not to be sustained on audit, based on the technical merit of the position.

### Asset Impairment – Goodwill

The Company accounts for goodwill and indefinite lived intangibles in accordance with ASC 350 "Intangibles – Goodwill and other". Goodwill is reviewed for impairment annually, or when events arise that could indicate that impairment exists. The provisions of ASC 350 require that the Company perform a two-step impairment test. In the first step, the Company compares the fair value of its reporting units to the carrying value of the reporting units. If the carrying value of the net assets assigned to the reporting units exceeds the fair value of the reporting units, then the second step of the impairment test is performed in order to determine the implied fair value of the reporting units' goodwill. If the carrying value of the reporting units' goodwill exceeds its implied fair value, an impairment loss equal to the difference is recorded.

At December 31, 2011, the market price of the Company's stock was trading lower than its book value for a prolonged period. The Company was required to acknowledge this as a possible triggering event and that an impairment may exist. In addition, the Company had reorganized its reporting unit structure to combine the three reporting units (Micron Products, New England Molders, and Leominster Tool) with goodwill into one reporting unit. The combined reporting unit better reflects the synergies between these components and aligns the segment with how management reviews and operates the business. An analysis of goodwill of the three reporting units prior to combining was performed to determine fair value using income and market approaches. The income approach is based on a discounted cash methodology that includes assumptions of, among other things, forecast income, cash flow, growth rates, and long-term discount rates, all of which require significant judgment. The market approach utilizes the Company's market data as well as market data from publicly traded companies that are similar to the Company. There are inherent uncertainties related to these factors and the judgment applied in the analysis. Management determined an impairment was required for the Leominster Tool portion of the goodwill equal to \$85,239. The Company changed the goodwill annual test date from March 31 to December 31 aligning the test with the year end audit. This change will provide more time for the Company to complete its assessment prior to its reporting deadline. As required, the Company's independent registered public accounting firm issued a preferability letter on the matter.





Asset Impairment – Long Lived Assets  
In accordance with ASC 360, "